

Message Text

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ACTION EA-09

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SUBJECT: INDONESIA NEGOTIATING FIRST THIRD-GENERATION MINING
CONTRACT WITH RTZ

REFS : (A) 76 JAKARTA A-87, (B) 76 JAKARTA A-147

1. SUMMARY: GOI IS CURRENTLY NEGOTIATING A CONTRACT OF
WORK WITH P.T. RIO-TINTO INDONESIA, INDONESIAN SUBSIDIARY
OF RIO-TINTO ZINC, FOR A BASE METAL PROSPECTING AND MINING
VENTURE IN SULAWESI. UNSETTLED ISSUES INCLUDE : (A) HOW
TO VALUE SHARES TO BE ACQUIRED BY INDONESIAN CO-PARTNER
IN FUTURE; (B) FORMULA FOR CALCULATING A "SUPER OR
EXCESS" PROFITS TAX; (C) CALCULATION OF ROYALTIES AND
EXPORT TAXES. BOTH RTI AND GOI ARE CONFIDENT AGREEMENT
CAN BE CONCLUDED WITHIN NEXT TWO MONTHS. RTI-GOI AGREE-
MENT WOULD THEN BECOME MODEL FOR SO-CALLED THIRD
GENERATION MINING CONTRACT WHICH COULD BE USED IN NEGOTIA-
TIONS WITH NUMBER FOREIGN MINING FIRMS THAT HAVE BEEN
WAITING FOR SUCH MODEL SINCE 1972. END SUMMARY.

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2. AS REPORTED IN REF B, IN AUGUST 1976 GOI ISSUED
PROCLAMATION ON TAXATION IN THE MINING INDUSTRY WHICH IS
INTENDED TO LAY BASIS FOR NEGOTIATION OF SO-CALLED THIRD-
GENERATION MINING CONTRACT (THE FIRST GENERATION BEING
THE CONTRACT BETWEEN THE GOI AND THE INDONESIAN SUBSIDIARY
OF FREEPORT MINERALS, AND THE SECOND GENERATION BEING

THE SERIES OF CONTRACTS LARGELY NEGOTIATED IN 1968). GOI HAS SINCE UNDERTAKEN THE NEGOTIATION OF SUCH A CONTRACT WITH RIO-TINTO INDONESIA (RTI), FORMERLY RIO-TINTO BETHLEMEH. RTI IS 55 PERCENT OWNED BY RIO-TINTO ZINC (RTZ), AND 45 PERCENT OWNED BY RTZ'S AUSTRALIAN SUBSIDIARY (WHICH REPLACED A 45 PERCENT INTEREST OWNED BY BETHLEHEM STEEL). GOI REPORTEDLY CHOSE RTI FOR PATTERN-SETTING NEGOTIATION BECAUSE: (A) IT IS OF "APPROPRIATE" SIZE,

ND (B) "THEY HAVE BEEN HERE FOR SOME TIME AND THEY KNOW US AND WE KNOW THEM." NEGOTIATIONS ARE FOR BASE METAL EXPLORATION/MINING RIGHTS IN "BLOCK 3" IN NORTHWEST SULAWESI. AREA IS REPORTEDLY COPPER BEARING.

3. BOTH SIDES AGREE NEGOTIATIONS HAVE MOVED ALONG WELL AND THEY ARE HOPEFUL A FINAL CONTRACT CAN BE PRESENTED TO INDONESIAN PARLIAMENT IN MARCH FOR ITS RATIFICATION. THERE ARE THREE OR FOUR ISSUES STILL UNRESOLVED. THE FIRST IS THE QUESTION OF THE INDONESIAN EQUITY INTEREST IN THE VENTURE. UNDER THE SECOND-GENERATION CONTRACTS INDONESIA IS TO ACQUIRE A 20 PERCENT INTEREST IN VENTURE WITHIN TEN YEARS AFTER IT COMMENCES COMMERCIAL PRODUCTION; IN ACCORDANCE WITH GOI POLICIES, UNDER THIRD-GENERATION CONTRACT INDONESIA IS TO ACQUIRE A 51 PERCENT EQUITY INTEREST WITHIN 10 YEARS. RTI HAS AGREED TO THIS IN PRINCIPLE, BUT HAS RAISED QUESTION AS TO HOW A FAIR VALUE FOR THIS INTEREST IS TO BE CALCULATED AND HOW IT WOULD BE ACQUIRED BY LOCAL INVESTORS. THE SECOND OUTSTANDING ISSUE IS A SUPER OR EXCESS PROFITS TAX. BOTH SIDES HAVE REPORTEDLY NOW AGREED THT EXCESS PROFITS LIMITED OFFICIAL USE

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ARE TO BE DEFINED AS PROFITS IN EXCESS OF 20 PERCENT OF TOTAL INVESTMENT (GOI'S INTITAL NEGOTIATING POSITION SUPPOSEDLY WAS 15 PERCENT OF EQUITY). STILL TO BE RESOLVED IS HOW TO CALCULATE EXCESS PROFITS; RTI POINTING TO VOLATILITY OF MINERALS' MARKET HAS ASKED FOR FOUR-YEAR MOVING AVERAGE WITH A FOUR-YEAR GRACE PERIOD, GOI HAS PUSHED A TWO-YEAR MOVING AVERAGE. RATE AT WHICH EXCESS PROFITS TO BE TAXED IS APPARENTLY ALSO UNRESOLVED; NORMAL PROFITS ARE TO BE TAXED AT 35 PERCENT RATE OVER FIRST TEN YEARS OF OPERATION, 45 PERCENT (NORMAL GOI CORPORATE TAX RATE) THEREAFTER; GOI WANTS TO TAX SUPER PROFITS AT 60 PERCENT IN FIRST TEN YEARS, 70 PERCENT THEREAFTER. THIRD AND FOURTH OUTSTANDING ISSUES ARE CALCULATION OF ROYALTY (GOI WANTS TO CHARGE ROYALTY BASED ON METAL PRODUCTION, RTI WANTS ROYALTY BASED ON METAL RECOVERY) AND CALCULATION OF EXPORT TAX. EXPORT TAX PROBLEM SEEMS TO BE AS MUCH ONE WITHIN THE GOI AS BETWEEN GOI AND RTI; DEPARTMENT OF FINANCE WANTS TO EXEMPT FROM EXPORT TAX ONLY FULLY REFINED METAL, DEPARTMENT OF MINING WANTS

TO EXEMPT CONCENTRATES FOR LARGE GROUP OF MINERALS FROM
EXPORT TAX.

4. WHEN CONTRACT IS FINALLY NEGOTIATED IT IS EXPECTED
TO BECOME MODEL FOR OTHER MINING VENTURES. IN 1972 WHEN
GOI CEASED USING SECOND GENERATION PRECEPTS FOR NEGOTIATING
OF MINERAL CONTRACTS SOME SEVENTEEN MULTI-NATIONAL FIRMS
HAD APPLICATIONS FOR CONTRACTS OF WORK IN INDOESIA PENDING.
GOI HAS CONTACTED THESE FIRMS TO INQUIRE WHETHER THEY STILL
INTERESTED. WE ARE INFORMED, BY NON-GOVERNMENT SOURCES,
THAT EIGHT FIRMS ANSWERED POSITIVELY, FOUR FIRMS ANSWERED
NEGATIVELY, AND FIVE FIRMS HAVE NOT YET RESPONDED. SENIOR
DEPARTMENT OF MINING OFFICIAL REFUSED TO CONFIRM OR DENY
THIS INFORMATION TO ECONOMIC OFFICER, OR TO IDENTIFY FIRMS
OR MINERALS IN WHICH THEY WERE INTERESTED. OFFICIAL DID
SAY HE BELIEVED HE COULD MAKE THIS INFORMATION AVAILABLE
TO US AFTER RTI CONTRACT CONCLUDED.
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NEWSOM

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